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Directorate of Intelligence

Economic Intelligence Weekly

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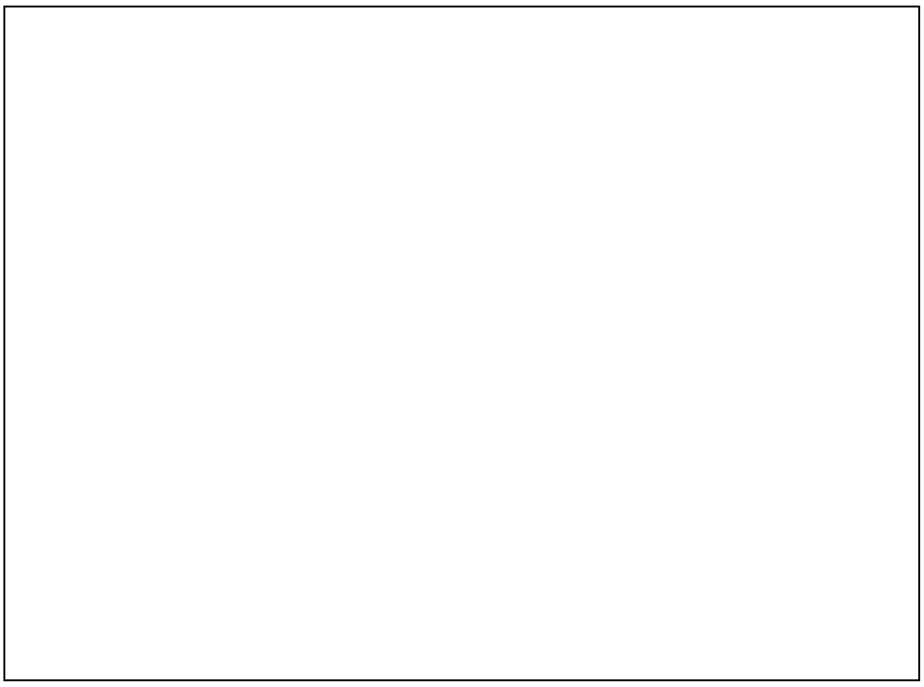


Peru's Economy Threatened by Hostage Crisis and Arms Purchases

The hostage situation—and Peru's struggle to balance demands for greater military spending against austerity pledges to the IMF—have raised fresh economic challenges for President Fujimori's government.

Lima has sought to reassure investors that the hostage taking is an isolated incident.

- Financial markets have recovered from the initial shock of the terrorist incident in mid-December. The government also claims Peru has received $1.5 billion in new foreign investment since then, ***but this figure probably represents gross direct investment or promises of future investment.***

If there is no quick resolution of the crisis, it may have an adverse affect on foreign capital flows, which are vital to sustaining growth.

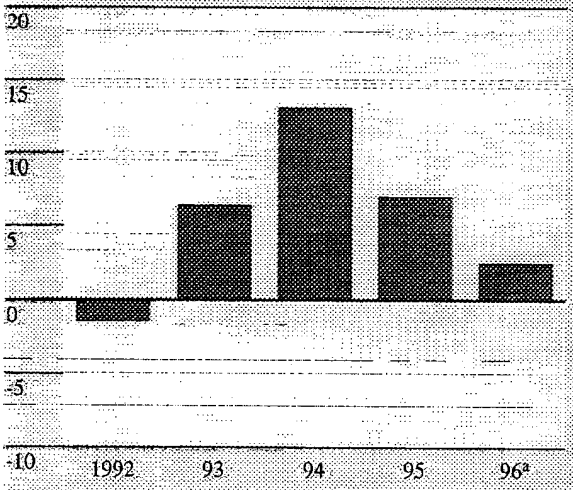
- Central Bank data suggests foreign currency bank deposits have fallen modestly since the takeover—the government attributes the drop to seasonal variations rather than capital flight—

Peru: Selected Economic Indicators, 1992-96

Note scale change

Real GDP Growth

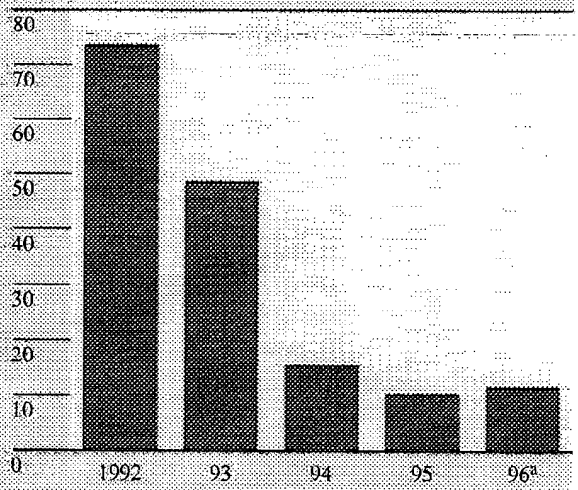
Percent



Source: WEFA, US Embassy reports.

Inflation

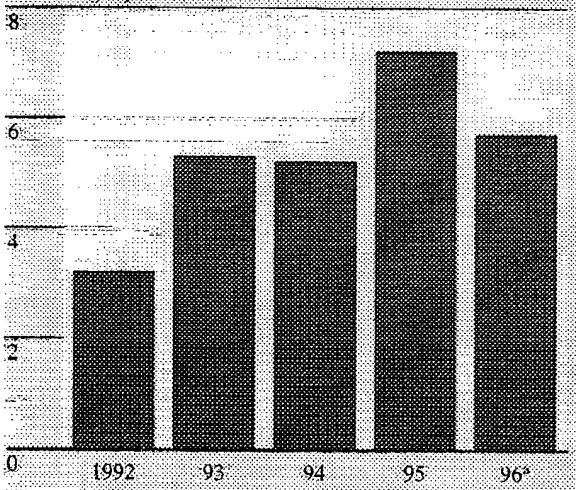
Percent



Source: WEFA, US Embassy reports.

Current Account Deficit

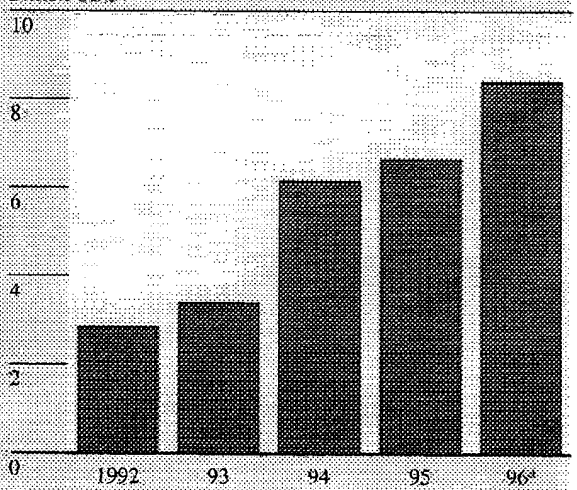
Percentage of GDP



Source: WEFA, US Embassy reports.

Reserves

Billion US $



Source: IIF, US Embassy reports.

[a]Estimated.

[redacted]ourism—a key source of foreign exchange—has suffered and [redacted] several US trade missions have been canceled.

- ***If capital inflows slow, Lima might have to finance its current account deficit by drawing down reserves***—now equal to more than a year's import coverage—***but significant capital flight would undermine efforts to sustain economic reforms.*** [redacted]

Lima also is seeking to assuage IMF concerns about its ability to fund recent MIG-29 acquisitions while meeting its future Fund targets.

- The IMF probably pressed Economy Minister Camet to explain how Peru funded the approximately $280 million purchase during his visit to Washington last week [redacted]

[redacted]

- ***Unless pressed by US or Fund officials, Camet probably will sidestep discussion of other military modernization plans and the use of off-budget accounts to fund military spending.*** [redacted]

[redacted]

[redacted]